Reciprocal Trade Agreements—A New Method of Tariff Making

by L. A. WHEELER [1]

IT IS inconceivable, says the author of this article, that the nations of the modern world, including the United States, will adopt a policy of free trade. The trend in recent years has been in the opposite direction. Tariffs there will be. The question then is what method of tariff making is the most advantageous for the United States, and more specifically, for American agriculture? The author holds that reciprocal trade agreements should be considered as a method of tariff making that is alternative to the older method based on the process commonly called logrolling. After briefly reviewing the historical significance of the tariff to farmers in the United States, he contends that the reciprocal-trade-agreement method of tariff making, while perhaps not all that is necessary for the most effective conduct of commercial policy, is better suited to present-day conditions, including those in agriculture, than the old method. This is a subject on which there has been much controversy, and the author frankly takes one side of the argument.

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IN JUNE 1934 Congress passed an amendment to the Tariff Act of 1930 which has since become popularly known as the Reciprocal Trade Agreements Act. The primary purpose of the act was to contribute to economic recovery in the United States by opening the channels of international trade. Specifically, this was to be accomplished through trade agreements between the United States and individual countries, in connection with which the President was authorized to make concessions to foreign countries, chiefly in the form of reductions in import duties on foreign products to the extent of 50 percent below the rates established in the Tariff Act of 1930.

This act has been in operation for 6 years. Altogether 22 agreements have been negotiated, 2 of which were with Canada. At the present time (March 1940) 20 are in effect. Approximately 60 percent of the total foreign trade of the United States is with the countries with which we have these agreements.

In the trade agreements numerous concessions have been made by the United States in the form of reductions in import duties. It has been estimated roughly that these reductions have resulted in a decrease in the average import duties on dutiable products from over 50 percent to less than 40 percent, ad valorem.[2] At the same time the United States has obtained numerous concessions from foreign countries in the form of improved treatment of American export products, either through reductions in import duties or in expansion of the quantities of particular products permitted entry from the United States.

The purpose of this article is to examine one aspect only of the reciprocal-trade-agreements program—its use as a method of tariff making in the United States from the point of view of the American farmer. No attempt is made here to examine in detail the concessions granted by the United States in the form of duty reductions on agricultural products. Nor is any analysis made of the concessions obtained by the United States in the form of reduced trade barriers affecting our agricultural exports.

Historically the tariff policy has been one of the major political issues in the United States. But it has been debated largely from the point of view of its effect on our manufacturing industries. It was not until the Tariff Acts of 1922 and 1930 that any particular emphasis was placed on the role of the tariff in protecting agriculture.

The tariff policy of the United States is of interest to agriculture chiefly from three points of view. (1) Import duties tend to restrict imports generally and thus restrict the amount of dollar exchange available to foreigners to purchase surplus agricultural products. (2) Such duties restrict imports of manufactured products and thus tend to raise the prices of things that farmers buy. (3) Duties restrict imports of agricultural products and thus, to the extent that they are effective, tend to raise the prices of those agricultural products not on a surplus basis in the United States. It is well understood, of course, that under ordinary conditions import duties on products such as cotton and wheat, of which exportable surpluses are produced, are of no value from a price-raising point of view, since such products have to be sold on a world-market basis regardless of what the United States import duty may be. The reason for this is that the surplus

[2] Computed by dividing total calculated duties collected by the total value of dutiable imports.

must be sold at world-market prices, which, in the absence of governmental intervention in fixing prices internally, will also apply to the quantities sold in the domestic market.

THE SIGNIFICANCE OF THE TARIFF TO THE FARMER

In approaching this discussion of reciprocal trade agreements as a method of tariff making, it may be useful to examine the relative importance of the tariff to the farmer from these several points of view during the period preceding the World War of 1914–18 and the period since the end of that war.

Before the World War

During the three decades prior to 1914, the United States was a debtor country—that is, we owed more to foreign countries than foreign countries owed us. Under these circumstances, it was necessary that we maintain what is popularly termed a "favorable" balance of trade—an excess of exports of merchandise over imports of merchandise—in order that we might have the means to make payments on our foreign debt, both capital and interest.

At first sight this really fundamental fact seems to have little bearing on the question of the effect of the tariff on agriculture. Actually it has had a very direct bearing. We had to export more than we imported. And the tariff, by restricting imports, helped to increase the excess of exports over imports. To put the matter another way, the fact that the tariff restricted imports during this pre-war period was of no great consequence from the standpoint of foreign purchasing power for our agricultural products, since, under the circumstances then existing, foreign countries, or more specifically, the western European countries importing agricultural products, had an adequate supply of dollar exchange to pay for their imports from us in spite of the fact that we restricted our imports from them through our tariff policy. This was true largely because, during this period, the amount of dollar exchange available to foreigners was augmented by our payments on our debts.

But looked at from the point of view of the effect of the tariff on the prices of things farmers had to buy, the situation was quite different. In the pre-war period the United States had not developed to its industrial maturity. In fact one of the outstanding arguments for the tariff was that it aided "infant" industries. During those years farmers bought, or would have liked to buy, many goods that were produced more cheaply abroad than in this country. The tariff prevented such goods from being sold in the United States at these low prices and thus penalized the farmer, who, generally speaking, was selling on the world market and buying on the domestic market.

From the third point of view—the effect of the tariff on prices of things farmers produced and sold—it is apparent that our tariff policy was of relatively little importance prior to 1914. Since colonial times American agriculture had been organized primarily on an export basis—that is to say, most of the important agricultural products were produced in excess of domestic requirements, and it was necessary to dispose of this surplus abroad. There were, of course, certain exceptions, the most important of which was wool. The United States has never produced any significant surplus of wool, and therefore the tariff has usually been effective in maintaining domestic prices above world prices. Whether this has been advantageous to American farmers in general is, of course, another question. In the case of sugar also the tariff has been effective, but in pre-war years even more than recently the number of farmers producing sugar was insignificant as compared with the total number of farmers. And all farmers consume sugar. Furthermore, before the war transportation facilities were not such as to permit a ready flow of some of the more perishable agricultural products which now enter in large volume into international trade, as, for instance, fruits and vegetables, dairy products, and meat. Even though we may not have had a surplus of some of these products, lack of transportation facilities was a more important factor in protecting domestic interests than our tariff policy.

It is evident, therefore, that in the pre-war years the one aspect of the tariff that was of particular interest to the farmer was the increase in the prices of things that farmers had to buy. The tariff gave little protection to the farmer as a producer, and there was no question of reducing foreign purchasing power for our agricultural export products through the tariff.

Since the World War

What has been the situation in the post-war years? First of all, the war changed the United States from a debtor to a creditor country. Instead of our owing large sums of money to foreign countries, foreign countries owed large sums to us. In this kind of situation it was necessary that our imports of goods and services exceed our exports in order to provide foreigners with the means of making payments on their debts. From this point of view a trend toward lower tariffs was clearly indicated. What actually happened was that the tariffs were increased, first in the Emergency Tariff Act of 1921, then in the Fordney-McCumber Act of 1922, and finally in the Smoot-Hawley Act of 1930. Partly for this reason foreigners did not get a sufficient supply of dollar exchange through exports to us to pay for imports from us and also to make payments on their debts. Nevertheless, during the 1920's our exports continued to expand. This was because large foreign loans by American citizens provided foreign countries with the necessary dollar exchange to balance the discrepancy between our exports to them and their exports to us. During the 1930's our export balance continued, although both our exports and our imports were on a much lower level. The principal factor sustaining foreign purchasing power since 1930 has been the purchase by the United States of huge quantities of gold.

In short, the change in the debtor-creditor status of the United States made it much more important than before the World War that imports be increased in order to provide foreigners with the means of paying for our export products and also to make payments on their debts. But the tariff policy of the United States during the greater part of the post-war period so far has worked in the opposite direction. The substantial disadvantage of the high-tariff policy to agriculture from this point of view was, however, obscured during the 1920's by the large flow of funds abroad in the form of loans.

What about the effect of the tariff on the farmer as a consumer during the post-war years? In general the high-tariff policy continued of course to operate to the disadvantage of the farmer as a consumer, just as it had in pre-war years. But there was a substantial difference in the degree of disadvantage. It is probably safe to say that the tariff has been less burdensome to the farmer as a consumer since the end of the World War, largely because many of our industries have increased their efficiency to a point at least equal to that of similar industries abroad. Some of them, such as the automobile industry, have surpassed foreign producers in efficiency of production. There are, of course, numerous examples of more or less monopolistic industries which, behind the protection of a high tariff wall, are in a position to demand higher prices than could otherwise be obtained. But those industries—and there are many of them—in which the technique of mass production has put the United States on an export basis are able to sell and, in many cases, do sell their products at prices below those of foreign industries. These include a great many of the staple items needed by the farmer, such as hardware, automobiles, tractors, and the like.

As a matter of fact, during the post-war decades it is probable that most farmers, as consumers, have been hurt more by the tariff on agricultural products such as sugar and wool than by the tariff on manufactured goods. In general, the effect of the tariff in boosting prices of things farmers have to buy has become less important than it was during all of the nineteenth century and the first decade of the twentieth, during which American industry was growing toward maturity.

Protection Against Foreign Agricultural Products

It remains to examine the significance of the tariff in protecting domestic agriculture against foreign competition. There continue to be, as in the pre-war years, relatively few agricultural products that are in a position to be benefited directly and significantly by import duties. But the list is longer than in our earlier history. The prime examples of effectively protected agricultural industries continue to be sugar and wool. To these flaxseed may be added. In a sort of border zone are three of the major agricultural industries of the United States—beef production, dairying, and poultry production. If no protection whatever were afforded to these particular industries it is conceivable that the imports from particularly favored foreign sources of supply would increase in some years to an extent that would be measurably disadvantageous from the point of view of our domestic producers.

The beef-cattle industry, for instance, has not been producing any surplus for export since the end of the World War. In fact in years of reasonable prosperity beef production in the United States falls below our potential requirements. Without any protection whatever against imports, in the form of either import duties or sanitary embargoes, there doubtless would be, in such years, a considerable importation of cattle from Canada and Mexico and of chilled beef from Argentina; possibly as much as 15 percent of our consumption would be imported.

In the case of the dairy industry, there seems to be little reason to doubt that in the absence of any protection there would be, particularly on a seasonal basis, rather large importations of butter from New Zealand and Denmark. Even now we import considerable cheese, although most of it is of foreign types.

The poultry industry is less subject to potential competition from abroad than either the dairy or the beef-cattle industry. Canada is the principal potential source of imports of both poultry and eggs, although in the event of free trade it is altogether likely that the United States would ship a great many more of these products to Canada than Canada would ship to us. In fact turkeys from Argentina are about the only poultry item that might be imported to the serious inconvenience of domestic producers; and even in that case it is doubtful in view of the increasingly efficient production of turkeys in the United States, whether Argentine imports would offer any considerable threat. There has been, it is true, long-continued agitation against imported dried and frozen eggs from China on the ground that such imports injure the American poultry industry. It is noteworthy, however, that the years in which dried-egg imports have been largest have been the years in which our poultry industry has been most prosperous.

Whatever might be the significance of imports under a free-trade system, the fact stands out that the prices received by producers in all these borderline industries are dominated by two factors: (1) The amount of domestic production, and (2) the level of consumer demand in the United States. It seems fairly clear that this would continue to be the case even though no duties whatever were assessed on imports of these products. Imports would be considerably larger than they are now when business conditions were good or when our supplies were short. They would be small in years when business conditions were poor or domestic supplies were large.

Probably the principal increase in foreign competition in the agricultural sphere since pre-war days is in tropical vegetable oils. Imports of these products for both edible and nonedible uses have increased enormously. It is probable, in fact it is practically certain, that the free entry of these products would result in a further increase in imports. To what extent such increased imports would affect the welfare of American farmers, it is extremely difficult to say and certainly beyond the scope of this article to explore.

Additional examples of increased foreign competition of somewhat localized character might be mentioned--for instance, in such commodities as winter vegetables from Cuba and Mexico. In fact, in the whole field of fruits and vegetables, foreign competition might be expected to be considerably keener than it was before the war in the event of free entry into the American market, largely because of the enormous improvement in transportation facilities for such products.

In addition to these examples of more or less direct competition, numerous instances have been brought forward of the indirect competition of substitute products the elimination of which would permit a substantial expansion of domestic production of products for similar use. An outstanding example frequently given is tropical starches, such as tapioca. It is probably true that complete elimination of imports of such starches would permit an expansion in production in the United States of substitute products, such as corn, potato, and sweetpotato starches. It is quite unlikely, however, that this expansion would redound to the benefit of producers in any significant way, since the complete substitution of domestic for tropical starch would require only a very small percentage of our products suitable for starch making.

Summing up, it may be concluded that from the point of view of the farmer as a consumer of nonagricultural products the tariff policy of the United States is of somewhat less significance than in pre-war years. On the other hand, from the standpoint of the producer of the agricultural surplus products such as cotton, wheat, hogs, tobacco, and many kinds of fruit, a high-tariff policy is a greater handicap than formerly, since in a creditor country it is essential that imports be greatly increased if exports are to be maintained. Finally it appears that insofar as he produces the deficit or self-sufficient products, the American farmer is in a position to receive more effective protection than during the era of agricultural expansion of the nineteenth century.

Numerous references have been made to what might happen in the event that import duties were abolished on particular agricultural products. Actually, complete free entry is outside the realm of possibility. The choice must be between different degrees of protection for both agriculture and industry rather than between protection and free trade. It is quite inconceivable, for instance, that any Congress would pass a tariff act with duties as low as those in the Underwood tariff of 1913, in which a great many agricultural products were on the free list. This being the case, the question arises as to how best to bring about changes in import duties in the interest of the country as a whole, and particularly in the interest of the farmer.

THE OLD METHOD OF TARIFF MAKING

Until the passage of the Trade Agreements Act of 1934 the historic method of tariff making in the United States was a complete revision of the tariff approximately every 10 years. Under this practice a tariff bill would be considered first by the Ways and Means Committee of the House of Representatives, when opportunity would be given for interested parties to present their views. The Ways and Means Committee would then report the tariff bill to the House, and after long debate and many revisions it would be passed and sent to the Senate, which, in turn, would refer it to the Senate Finance Committee. The Finance Committee would then go through much the same procedure as had the Ways and Means Committee. After further changes in rates of duty and general provisions by the Finance Committee, the bill would be reported on the floor of the Senate. Another more or less prolonged debate would take place in the Senate, and additional changes would be made. Finally the bill as it passed the Senate and the bill as it passed the House would be referred to a joint conference committee to iron out discrepancies. After the conference committee had agreed upon it, it would once more be submitted to the Senate and the House for final approval before being sent to the President, who would decide whether to approve or disapprove the measure as a whole.

The net result of this kind of procedure was, of course, something considerably short of a "scientific" tariff. In general the tariff rates on particular products were arrived at through a complicated process of compromises and deals. The ultimate result was likely to be heavily weighted on the side of the interests of the protected industries as compared with the interests of consumers and of the producers of our export products. In fact the system permitted export interests little opportunity to make their views heard. One of the best examples of the farmer's getting outtraded in this tariff-making process was the case of hides and shoes in the Tariff Act of 1930. In the course of the passage of that act it is said that agricultural support for a tariff on shoes was obtained on the basis of putting a tariff on hides, which were formerly on the free list. But the tariff on hides was put at 10 percent ad valorem and that on shoes at 20 percent. And the 20-percent tariff on shoes was largely effective, while the tariff on hides had very little effect on the prices livestock producers received for their cattle.

It is true that in the Tariff Acts of 1922 and 1930 a gesture toward greater flexibility and change in the rates of duty embodied in a general tariff act was provided in the so-called flexible provision (sec. 332 of the Tariff Act of 1930). This section provides for investigations by the Tariff Commission of differences in costs of production at home and abroad and gives the President authority to increase or reduce tariff rates by as much as 50 percent on the basis of such findings.

As a matter of fact, however, relatively few cases were investigated in comparison with the total number of items in a tariff bill. And in most cases where action was taken the duties were increased. There is good reason to suspect that the principal element of flexibility lay in the possibility, under the difference-in-cost formula, of making the facts fit the conclusion rather than the conclusion fit the facts. However that may be, the fact remains that the principle of adjusting tariffs according to differences in costs of production is impracticable. It is impossible to say just what the difference in cost of production actually is. There are, first of all, great differences in quality which an average difference cannot by the nature of things take into account. There are also great differences between the products and costs of individual producers within the United States and also within particular foreign countries. But in the case of agricultural products, further difficulty results from the fact that the cost of production in a particular year is determined to a very marked extent by the yields obtained. And the yields are, of course, determined to a large extent by weather conditions. Taking corn as an example, the costs of production per bushel during the years of extraordinary drought in the United States, 1934 and 1936, were far above those in, say, 1937, when the weather was favorable and yields generally were high. So far as the tariff is concerned, it might well be argued, and in fact it was argued by many farmers who had to buy corn for feed in the drought years, that the duty should be reduced or eliminated. But according to the cost-of-production formula, the duty should have been increased in those years.

Differences in cost of production should of course be taken into account in tariff adjustments, but to rely upon such differences to the exclusion of other considerations must inevitably lead to absurd results.

TARIFF MAKING UNDER THE TRADE-AGREEMENTS PROGRAM

That the reciprocal trade-agreements program is, among other things, a new method of tariff making is attested by the fact that reductions have been made in the duties on articles in 420 paragraphs out of a total of about 730 paragraphs in the Tariff Act of 1930, or almost 60 percent. Furthermore, a considerable number of duties have been "bound"—that is, guaranteed against increase—and an additional number have been bound on the free list. Up to the present time no increases in duties have been made under the Trade Agreements Act.

Under the trade-agreements program the procedure has been as follows: First the Department of State announces the intention to negotiate a trade agreement with a particular country; in recent years it has announced also the commodities on which the United States may grant concessions in connection with such an agreement. Next, public hearings are held by an interdepartmental committee known as the Committee for Reciprocity Information, made up of representatives from the Departments of State, the Treasury, Agriculture, and Commerce and the United States Tariff Commission. At these hearings representatives of domestic producers advance arguments against duty reductions on particular products, while representatives of import interests advance arguments in favor of duty reductions. Representatives of export industries are also present and indicate concessions they would like to see obtained from foreign countries on their particular products.

The information developed in these hearings, together with all available information on the subject in the various Government departments, is carefully reviewed by a special interdepartmental subcommittee (known as a country committee because it handles the detailed work relating to an agreement with a particular country), established to work on the agreement in question. This subcommittee reports its findings to the interdepartmental Trade Agreements Committee, which is also made up of representatives of the Departments of State, the Treasury, Agriculture, and Commerce, and of the United States Tariff Commission, under the chairmanship of the Department of State. The Trade Agreements Committee considers in detail the recommendations of the country committee and, with such changes as may seem appropriate, passes its recommendations along to the Secretary of State and the President. These recommendations include not only concessions that are desired from the foreign country in question but also definite suggestions as to the extent to which the United States might without serious injury to domestic industries make concessions in return. All of this procedure is gone through before the negotiations actually start. In the course of the negotiations any questions that arise are sent back to the Trade Agreements Committee for consideration and are passed on to the Secretary of State and the President for final approval or rejection.

This, in brief, is the mechanism of the trade-agreements program. What are its advantages over the historic method?

There are four major points in which it has greater flexibility: (1) It gives an opportunity for careful and detailed consideration of the economic aspects of each individual case upon which duty reductions may be proposed. (2) It provides for subclassifications of particular products, so that the great bulk of classes in which domestic products predominate can be excluded from the duty reduction, which may apply only to the particular kinds and classes of articles in which the foreign country in question is primarily interested. (3) Duties may be reduced on a seasonal basis, that is, only during those months of the year in which domestic production is nonexistent or very small; this, of course, applies primarily to agricultural products. (4) Reductions may be applied on specifically limited quantities. The last, as an outstanding development in tariff making under the reciprocal trade-agreements program, deserves special mention.

Under this practice, in cases where it seems likely that if the duty were reduced imports might increase greatly, to the distinct disadvantage of American producers, the procedure of limiting the quantity on which the duty reduction will apply has been adopted. An outstanding example of such procedure is found in the duty reduction on cattle in the trade agreement with Canada. In the first place the duty reduction applies only to certain classes of cattle, namely, (1) those weighing over 700 pounds, (2) dairy cows, and (3) calves. In the second place, except for dairy cows, the reductions apply only to specified quantities. And in the third place, in the case of the heavy cattle in which competition is most important, the reduction applies to only a certain number of cattle in each quarter of the year. By this means it was possible to grant to Canada a concession on cattle which permitted a substantial increase in her exports to the United States and at the same time assured the domestic producers against a flood of imports. In the case of the heavy cattle, for instance, the duty reduction applied to a quantity representing only 1½ percent of our annual slaughter of cattle and calves.

But perhaps the principal advantage of the trade-agreements method of tariff making over the older method lies in the fact that it takes into account directly the interests of our export industries. It would, of course, be possible, if it were politically feasible, to have a general revision of the tariff act in which duties were generally reduced as compared with those in the preceding act. As a matter of fact, such a revision has been made on a few occasions in our history, although the general tendency has been upward rather than downward. But even if import duties were reduced, which would be an advantage from the standpoint of foreign purchasing power, there would be no assurance whatever that foreign restrictions on our export products would also be relaxed. Under the trade-agreements method reductions in foreign restrictions are definitely assured, since it is on the basis of such reductions that concessions in the form of duty reductions are made by the United States.

One additional argument may be advanced in favor of the trade-agreements approach, namely that it puts the Government of the United States on a more equal footing with other countries in the field of international trade. The days of nineteenth-century laissez faire have passed. Since the beginning of the World War, governments everywhere have taken increasingly direct control in matters of foreign trade. By this it is meant that in practically all foreign countries important in international trade the executive branch has authority quickly to change import duties, establish import quotas, and otherwise control foreign trade, and this authority is exercised. It is important in this situation that the executive branch of the Government of the United States be empowered to act quickly and effectively in meeting particular situations brought about by such actions of foreign governments. The authority to conclude reciprocal trade agreements may not be all that is necessary but it does add greatly to the bargaining power of the United States in meeting particular situations.